

**“Weathering the Regulatory Storm”**  
**Transcript of**  
**JPMorgan Investor Services**  
**First *Thought* Magazine Webinar**  
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Presenters:

**Neil Henderson:** Senior Vice President, Securities Processing and Fund Services Business Executive, JPMorgan Investor Services. **(See page 2 of presentation)**

**Sheenagh Gordon-Hart:** Vice President, Head of Strategy, Research and Government Affairs, Europe, Middle East & Africa, JPMorgan Investor Services. **(See page 3)**

**Virginia Meany:** Senior Vice President, Global Fund Accounting Administration Business Executive, head of Compliance Services, JPMorgan Investor Services. **(See page 4)**

**Greg Pickard:** Vice President and Associate General Counsel, JPMorgan Investor Services. **(See page 5)**

**Michael Leary:** CPA, Vice President and Senior Manager of Fund Administration and Manager of Compliance Solutions, JPMorgan Investor Services **(See page 6)**

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Neil Henderson:

We are pleased to welcome you to the first ever *Thought* magazine Webinar. My name is Neil Henderson, JPMorgan Investor Services’ Securities Processing and Fund Services executive and I will be your host today. **(See page 2)**

Our theme today is regulation and compliance, considered by many to be among the top industry drivers in 2005. Whether it is Sarbanes Oxley, UCITS III, the Financial Services Action Plan (FSAP) or the Chief Compliance Officer Rule, new regulations are emerging from every direction, in countries around the world.

As an organization, and a top service provider, we believe it is important for us to take a leadership role in developing best practices with regard to industry regulations. Because this is such a significant concern for all industry participants, we have dedicated this first

in a series of *Thought* magazine Webinars to aspects of the current regulatory environment that we hope are of interest to you.

The fourth quarter edition of *Thought* should have arrived in your mailboxes over the past few weeks. What we will do today is take two of the articles from that issue, “Weathering the Regulatory Storm,” and “Regulation: Will Europe’s Financial Services Action Plan Succeed?” and bring them into this virtual meeting space for a more in-depth dialogue.

We have assembled an impressive panel of experts to help lead us in today’s discussion. We hope to give you some perspective on what we believe are some of today’s most important regulatory and compliance issues.

We want this forum to be as interactive as possible so we encourage your participation. You will have the opportunity to ask questions after each presentation, as well as during the open Q&A session later in the Webinar. We will also conduct several Polls during the Webinar; this is a chance to get a pulse on various other issues relating to today’s topic.

Our first presenter today will be Sheenagh Gordon Hart. Sheenagh is Vice President and Head of Strategy, Research and Government Affairs, from JPMIS Europe, Middle East & Africa. Sheenagh will discuss what 2005 holds from a European perspective in terms of regulations and compliance. She will give us an update on some of the major areas of regulatory focus for 2005 including completion of the Financial Services Action Plan (FSAP) and UCITS III. **(See page 3)**

Next we’ll hear from Virginia Meany, Senior Vice President and Global Fund Accounting Administration Business Executive. Virginia will briefly review the requirements for the SEC Rules 38a-1 and 206(4) 7 as well as share some insights from the recent NICSA1 conference on compliance. Virginia is a member of the board of directors of NICSA. **(See page 4)**

Then we’ll hear from Greg Pickard, Vice President and Associate General Counsel. Greg will discuss some of the guidance from the SEC with regard to CCOs and what constitutes an effective compliance program. He will also review some of the particular areas of interest for Investment Companies. **(See page 5)**

Finally Michael Leary, CPA, Vice President and Senior Manager of Fund Administration and Manager of Compliance Solutions will discuss some of the controversy around third party reports as well as present some of the alternatives. He will also give us an overview of JPMorgan Investor Services’ Compliance Solutions Program and some of the support services that we provide. **(See page 6)**

So without any further delay, why don’t we get started and go over to Europe with Sheenagh Gordon-Hart. Sheenagh please...

**Sheenagh Gordon-Hart:** Thank you very much Neil, good morning everybody. I am going to be talking about regulations in Europe, in particular relating to financial services, and certainly over the past few years we've seen some challenges.

The Financial Services Action Plan (FSAP), with more than 40 directives, has certainly taken up a great deal of time both at national government level, the European level, but also drilling down into the financial services community itself. And that's what I am going to be discussing today.

Let's start with a Polling Question. **(See page 8)** Something I think is quite interesting...the Centre for the Study of Financial Innovation published its annual "*Banana Skins*" survey a couple of weeks ago. This is one of the quotes from the Chief Executive of the International Securities Market Association. He said that, "Regulation will inevitably lead to a more sanitized market, less dynamism and lower profits."

In fact, this is backed up by the fact that in this particular annual survey, regulation as a threat that effects the financial services industry went from the #6 position as a threat last year, to the #1 position this year. If you'd like to vote on that particular poll we can see the results coming up now. It looks like 53% of you don't agree with John Langton's2 quote. That's interesting, perhaps it would be interesting to take a geographic poll of where people are dialing in from. Certainly in Europe we have felt the pressure and the costs of regulation in the past five years and it has weighed heavy.

If we could move on to the slides, **(See page 9)** the things we are looking at from 2005 on will be the completion of the FSAP. We're almost there on it. This year should see it completed. In particular, the discussions that have been going on amongst the securities regulators nationally, in consultation to try and assure that there is a reasonable level of implementation across Europe and that there is not too much arbitrage around the regulatory scene.

The Himalaya Report is quite important because it is a preliminary review effectively of the FSAP. It looks at how Europe could adopt appropriate regulatory methods and tools in the securities market. But unfortunately, despite the fact that it argued pretty coherently in my view for a greater coherence in Europe amongst regulators and perhaps even a single voice amongst regulators, national governments have given this a very cool reception.

It will be interesting to see where the Himalaya report goes from here. I think probably we're going to see The Committee for European Securities Regulators (CESR) back off at this stage. Maybe it's just too early to discuss concepts such as possibly a super regulator in Europe. But it's interesting that in certain respects, we are seeing the development of lead regulators with certain directives that are being adopted, and I think that makes sense. It's certainly efficient, and I hope that governments will see the benefit of it in the long run.

Also in 2005, there will be a review of the Lamfalussy Process. This a four step process, that looks at firstly enacting legislation and then regulators getting together, discussing and agreeing on implementation. Ultimately, there are big questions around enforcement. Certainly the current view is that enforcement in Europe leaves a little to be desired, and in fact, we need a little more speed and direction in the enforcement process. We will see where that goes.

Basel II, I presume everybody is familiar with. There are some difficulties in Europe around it, particularly with getting to the first reading stage. There is a question mark over whether this particular directive associated with Basel II will be fast tracked. Certainly there is a lot of heat around it, because fast tracking doesn't allow for oversight by the elected members of the European Parliament to any great extent. We'll have to see where that particular argument goes.

Several tax cases pending in the European Court of Justice in virtually every country in Europe could be quite important in terms of establishing, for example, whether there should be equivalent treatment of pension investments between one country and another. I am watching that very carefully.

Pensions are obviously a big issue in Europe because of the pensions time bomb, the inversion of the population pyramid. We may well see a draft directive of portability of pensions in the first half of 2005. That won't necessarily give us a true single market for pensions in Europe, but it could be a step in the right direction.

Next slide (**See page 10**) UCITS III, those of you who are involved with asset management in Europe will be familiar with UCITS III. It took us almost 20 years to get to the revision of UCITS legislation in Europe. The first directive was in 1985. Unfortunately, despite good intentions, it has turned out to be a bit of a mess. And at last month's CESR meeting, they had to review guidance on the implementation deadlines because what, in fact, was happening was that some regulators were not playing necessarily entirely fair and refusing to recognize authorized funds that would have been recognized under UCITS I and the like.

CESR guidance is actually quite difficult to understand. You have to actually draw a fairly complex map to work out which deadlines fall when. It's at least clearer now. Arguments are going on over the application of the management company directive. In fact, it looks as if we might as well not have had that directive, because what we haven't got is true pass porting of all management company activities. We are expecting a Commission communication on asset management toward the end of year and it's certainly our view that the commission will take a very focused approach, which is to be welcomed as far as we in the industry are concerned.

The Taxation of Savings Directive is very much into the implementation stage from the first of July of this year. There is still a great deal of work to be done in terms of systems, transfer agency, and fund accounting. Clarification is needed on the inter play of rules between jurisdictions, and we still require clarification from Switzerland on their

treatment of this under their bi-lateral treaty under the EU. But hopefully, everybody will be ready on time, or in the position to do effective catch up.

Market in Financial Instruments Directive (MFID) is also on the books of course. CESR is consulting on implementing measures and we're expecting those to be finalized this year. There is a big question mark still hanging over securities clearing and settlement. There will be a policy document this year. The European Parliament has gotten involved in this now and will be publishing its own initiative report this month we believe. The question mark here is will we have a directive? We don't know yet. I know the commission is anxious not to table the directive if it isn't going to be strictly necessary or productive. And then there are a whole series of other issues that are on the table. Third Anti Money Laundering Directive, and numerous other issues, including corporate governance, share holder rights, and so forth.

Next slide (**See page 11**). The new commission that we have now, with Charlie McCreevy as the Internal Markets Commissioner, is called the Barosso Commission. I think we all hope great things from them for a more focused approach. Certainly the language is much more positive than it has been in the previous five years. They do not want to mass an agenda that is too challenging. They want to get right what they've got on the books at the moment.

Certainly economic competitiveness is a critical issue for this Commission. We know that by 2010, Europe is supposed to be one of the most competitive economies in the world if not *the* most competitive economy. And Martin Wolf<sup>3</sup> of the Financial Times said that this shows the EU has a sense of humor, but the tune is no longer funny. Certainly Europe has some challenging times ahead. Economic reform is going to underpin the achievement of anything like those objectives.

So that really sums it up for 2005 going forward. I think we've got a Commission that is business friendly, financial services friendly and certainly I think the asset management community in its broadest sense should find the environment much more inviting over the next two to three years.

Thank you very much. I'll hand you back to Neil now.

**NH:** Sheenagh let me ask you. The EU Savings Directive, we're working pretty hard on this ourselves to make sure we're in compliance, and it comes in I believe on July 1, where would you say the industry is overall and is everybody going to be ready?

**SGH:** I hate to say, I don't think everybody will be ready. Because I think there is an awful lot of clarification needed around interpretation of what constitutes interests, what are grand-fathered stocks and how the calculations are done. I think the other thing is, strangely enough, that people are just waking up to the fact that it isn't as straight forward as saying Luxembourg will default to withholding tax and Dublin will report. What we're finding is, for example, in the Fund of Funds situation, if you have a Fund of Funds in Luxembourg that invests in underlying funds in Dublin, reporting isn't necessarily

going to be good enough, because the Luxembourg fund is going to want calculations of the taxable income per share.

Under current rules, and in fact in terms of current interpretation by most players, there is no intention to calculate that figure. We are intending to calculate, in the absence of guidance from Dublin, because there is none in this particular instance. We are calculating on the basis of the Luxembourg rules, so that at least for those of our clients for whom it is relevant they will have the figure.

But no, I don't think the industry as a whole is ready. There is going to be a bit of a scramble towards the end of the year to get everything sorted out and in place. We're as close as we can be to being ready at this stage. Everything is on track, and the testing is going well.

**NH:** That's great. One of the things you touched upon, is a single market for pensions in Europe, which has been talked about for some while, realistically do you see anything occurring in the next 3 to 5 years?

**SGH:** Yes I do, predicated on a number of other things. I am very interested in the Commission's response to a recent independent report that was furnished to it by a group lead by Invesco. Who argued a very strong case for listing the regulatory and tax impediments to cross border mergers in Europe. And that's a very long way around to say, that if the Commission could tackle that, it would set the scene for Europe wide effective equivalent 401k- type schemes.

If we could overcome those barriers, if we could remove those barriers and get the tax situation sorted out, we could very well see something equivalent to the 401k market in Europe for our clients, fund managers, asset managers, mutual fund managers and for the end investor, whom everybody cares about a great deal in Europe.

**NH:** Ok, that sounds good. If anyone has further questions for Sheenagh just hold them until the end we should have some time to answer more questions. At this stage I am going to hand it over to Virginia Meany.

**Virginia Meany:** Good day to everybody, and thank you Neil. I think we want to do a Polling question first (**See page 13**). What we thought would be interesting for members of the audience would be to tell a little bit about the role that you play within your organization. Clearly there are many different roles and many different functions that need to contend with changes with regard to securities regulations. So, we thought it might be interesting to know what the make up of the audience was.

We are seeing that 75% of our audience is assisting with the compliance function and activities. And 17% is none of the above. It looks like we've got a mixture of interested parties, those that are directly affected by the regulations, as well as those that are very interested in them.

On the first slide (**See page 14**) in general, and I think creating a parallel to what Sheenagh has been talking to us about as well, clearly there a lot of new regulations, so we know the *what*. But the challenge is for us, as members of this industry, is to determine the *how*. And really that's where a lot of the recent industry discussions have been directed recently.

In the US there have been numerous instances of misconduct, particularly in the distribution and trading of mutual funds. And this has lead to a broad and comprehensive reexamination of securities regulations. The regulators are seeking greater transparency around policies, procedures and controls. And really to attain that end, the Securities and Exchange Commission (SEC) adopted rules 38a-1 and 206(4)-7 of the Investment Company Act of 1940 and Investment Advisors act of 1940. This is known commonly in our industry as the CCO regulation. The CCO regulation does apply to both the Investment Company and the Investment Advisor.

In just giving you high level information about the regulation, and I suspect that many of you do understand this as well, but the requirement is that mutual funds appoint a CCO or Chief Compliance Officer. This regulatory requirement needed to be met by October 5, 2004. It also required mutual funds to adopt policies and procedures that are designed to prevent violations of securities laws. And I am taking that language "*prevent violations of securities laws,*" right from the legislation.

Then there are seven federal securities laws that apply to this particular mandate. Finally, and this is finally an area that gets into how do we implement the regulation, the law requires that the Board of Directors review, on an annual basis, the policies and procedures for their effectiveness. So we know what the law requires, but however, the question really is how do we best as an industry implement that particular policy? And how do we meet the regulations? And this is really where a lot of the industry discussions are focusing of late.

Look to the next slide (**See page 15**) I'll talk a little bit more about the details of the rules. The October 5th deadline, for the employment of the CCO, has passed and the journey has begun. And I think that is very much what we're all engaged in, the journey towards satisfying the regulation. In a few minutes Michael Leary, who is the Compliance Solutions Program Manager for JPMIS, will discuss our response to the regulations. But I'd like to discuss, maybe in a little bit more detail, in general what the regulation is all about.

The regulators expect fund managers to prevent violations of the law, but they also expect us to be able to detect violations and take corrective actions. So the second two points are an important component of the regulation. That is, not only do we need to prevent the violations, but in the event that there is a violation, or there is an issue that needs to be dealt with, that the fund manager needs to be able to detect what that violation is, and then needs to be able to take corrective action.

The policies and procedures must be comprehensive, they must be written and they must be approved by the Board of Directors. It is important to note that the Board of Directors needs to be involved in this process. The SEC has mandated their involvement. Again, I think a valuable discussion is... what is too much or too little disclosure surrounding the requirement? I think that we'll see that there are many, many discussions within our industry today about the practical application of what the term *comprehensive* means.

We know what a written policy would look like, the fact that it needs to be comprehensive and needs to be approved by the Board, and in a way that is inexplicable to the Board, I think is something that we as participants in the industry are working through. And finally, again, I'll point out that the Board involvement is an important component of the regulations.

From looking at just the appointment of the CCO for a second, this has been a focus of the SEC in some of the early examinations. The SEC is particularly interested in inquiring about the credentials of the CCO, and in particular ensuring that in asking about the status in the organization and looking at the oversight mandate to be sure the CCO has the tools and the authority to get the job done. They want to ensure that there is a compliance program within the organization that meets regulatory guidelines.

I'd also like to mention that additional disclosure to the Board is required when there are significant changes to the environment or when there are reportable compliance issues. As we all know in this industry, we work in a very integrated and complicated environment. And there's a lot of sharing of data and there's a lot of functions that need to be performed, and periodically there will be issues. These issues need to be reported and need to be brought to the attention of the CCO and ultimately to the attention of the Board.

The industry is really attempting, I think with many of the panel discussions and conferences, really to answer to the level of disclosure that might be adequate. I think with conversations like we're having today, and we really appreciate engaging with this audience in the discussion, I think that there can be greater clarity in learning what one another are doing.

If we could turn to the next slide (**See page 16**) just looking at what's new on the horizon. In November 2004, the SEC approved a rule to require the registration of certain hedge fund advisors with the SEC. This action now requires the hedge fund advisors to appoint their own CCO and this is also a requirement that is made for an industry that has not been significantly regulated in the past. The second thing that I would note as well, we are going through this period, this journey that began October 5, 2004, but an important touch point is the second quarter of 2006. That's the deadline for the first comprehensive report on the effectiveness of policies and procedures that must be made to the Board. And our understanding is that with many of our clients, as well as the majority of the CCOs that we are talking to, the implementation of this report will be done well before the deadline is met.



If you could turn to the next slide (**See page 17**) the regulatory pitfalls. As I was saying, we're going through a period of clarification, monitoring and implementation. There have been several areas that we think merit mention in terms of direction and guidance that we've received from regulators, as well as other members of the industry. Some were discussed at the recent NISCA conference.

The SEC has indicated that it will be reviewing the role of the CCO, the mandate of the CCO, and deciding if the CCO has the necessary authority to implement a program. It's also important to note that there is a significant administrative burden when we look at monitoring, testing, implementation, the review of score cards, the annual review and affirmation to the Board that the policies and procedures are in compliance.

There are a lot of touch points, there are discussions, there are site visits, and a significant administrative burden that is necessary in order to respond to the regulation. And I think that this burden, particularly with some of the smaller asset managers, becomes even more significant. But it is important to ensure that there is appropriate preparation to absorb the administrative burden of complying with the regulations. It is also important to note, and this came from the regulators who were at the NISCA conference, that to take a comprehensive view of service providers.

So whether or not there is explicit mention within the regulation that there needs to be a broad view of service providers, the role that they play in providing service, as well as complying with the regulation and being able to demonstrate compliance with the regulation, is absolutely critical. The scope needs to be broad. The SEC also expects that there will be issues to report. Again ours is a very complicated industry, there's a lot of complicated processes and technologies that talk to one another. There are areas of risk. There will also be areas where there will be issues, and the scorecards and the reporting will indicate areas of issues.

The SEC really expects that there will be issues that mutual funds and asset managers will want to cite as areas of focus. Not only are they to cite these areas, but also be able to demonstrate that these are corrective actions, or there are risk mitigates that have been put in place in order to be compliant with the regulations. So it's a long way of perhaps saying that replying, "We don't have any issues," might be a red flag to the regulators. There is also considerable discussion within the industry with the Investment Company Institute (ICI) and the American Institute of Certified Public Accountants (AICPA) about the need for an independent third party audit report, whether that entails expanding the existing SAS 70, or coming up with a new report. We, as well as many other players in the industry, will work with all the appropriate parties on really defining and participating in the discussions about the third party audit requirements.

If you could turn to the next slide (**See page 17**), I'll just talk very briefly about what we think might constitute a strong compliance program. As I said, at the recent NISCA conference, there was a lot of discussion about what the aspects of a strong compliance program might be. Again, the global view, the broad and deep view is very important. The need for comprehensive and strong management reporting on a periodic basis seems

to be extremely practical. I think all of the panelists at the recent NICSA conference, and Michael Leary will probably talk about this as well, would agree that the need to be able to report on a regular basis, to note trends, irregularities in trends, and what corrective actions might be taken, are also a value and key requirements of the program.

Concentrate on the high risk areas that have already been identified. We know that there are areas that we, as service providers or asset managers, have identified as key areas of risk that require our attention. We can identify those areas, look for the risk mitigates, look for the trend and benchmark reporting that really can reflect what progress we've made in either correcting a high risk area, or reporting on our ability to manage through a high risk area.

Market timing remains a hot topic with the regulators. So certainly the ability to detect trading churning, subs and reds that might fall out of tolerances, is extremely important, and again areas of high risk should certainly be areas of focus. And the expectation would be that the service providers and the asset managers would work together in noting the areas of risk and coming up with strong measurement practices to support the focus.

**NH:** Thank you Virginia. Now lets move on to Greg Pickard.

**Greg Pickard:** Thanks Neil

Let's start with Polling Question #3 (**See page 20**). This is a question we thought would be interesting. Have you recently been contacted by the SEC? Interesting results so far, 14% have been contacted, 14% relating to CCO function and looks like someone's been in touch with the SEC in terms of a CCO exam in general. Over half haven't been in contact with the SEC.

Those results are certainly interesting to me. Just to draw back to Sheenagh's remarks, one of things I'd like to discuss is...is regulation good? Is government examination of industry good?

I think if you go back about 100 years to the presidency of Teddy Roosevelt, you'd see that in response to corporate abuses of the Trusts, he came down very hard on business. And while there was strong objection, in the long term that action was seen as very good for business. The government regulatory activity, indeed over the long term, is probably going to have a net positive effect. Not to suggest that it would be something we enjoy going through at the time. But in the end, I think the SEC has responded to the wide range of abuses that have occurred in the past decade with a dramatic number of new regulatory initiatives. Certainly more new rules than I've seen in my career and that many other lawyers have seen. It has been a tremendous effort by the SEC.

In terms of responding to these new rules, it has been a difficult challenge for all of us. I know that our CCO response efforts here have been time consuming and have taken up the resources of a large part of the organization. On the subject of SEC exams, I think the SEC is similarly constrained by resources and has had a hard time scaling up to get these

exams up and running, but has begun to put in place a wide range of themed exams that are originating from its various regional offices across the country. That is recognition by the SEC of the strain on its resources. I know they've been hiring, but at the same time, it's a large industry and even fully hired they are thinly staffed.

As you all know back in the fall, in connection with the October 5th deadline, the SEC was in touch with many funds and advisers by phone to make telephonic inquiries. In the past, the SEC's exam program involved the SEC exam staff arriving, submitting a letter, and usually giving the fund or advisor some time to put the response together. Usually that letter was a standardized letter that asked for a variety of things, and then the SEC exam staff would start to tear into whatever was responded with. It was sort of a needle in the haystack type of situation.

In today's world, the SEC has come up with a variety of new ways to conduct exams. Themed exams are more the standard format of the SEC exam. The SEC will arrive and submit a series of themed questions on a particular area where they are interested in looking. Usually, the theme is based on some type of disclosed or known abuse that has occurred somewhere else. Not a big surprise to anybody, at a recent conference that I attended, Gene Gohlke<sup>4</sup>, from the SEC Inspections Office, explained that he expected a number of themed exams in 2005. He went on to read a long list of different areas where he thought the SEC examination staff would spend its time.

Many of them relate to the areas where abuses have occurred in the past, often with regard to the pricing of different types of fund securities. We've already seen themed exams in the international area. He was also talking about themed exams in the small cap and high yield areas. The one note that I would say, is that the one place where we haven't seen any public discussion yet is in connection with results of the SEC's CCO related examination letter.

Now the point I would make here, is that the SEC is not trying to hide the ball on anybody. The SEC is very up front with its exam program. If anyone has any interest in knowing what the SEC is going to be asking, the draft form request letters are available. They publish them in numerous formats. One thing that any compliance staff has the ability to do at this point is take a look at those letters and see what kind of things the SEC is going to ask for. They certainly aren't shy in terms of making it clear what they are going to be looking for.

I have those letters and would be happy to provide them to anyone who would be interested in copies, just let me know. The other new element to the letter that I'll mention is that the SEC is asking for a meeting with senior management at the fund or the advisor. That's right in the first paragraph of the letter. They're asking for a high level presentation about the tone at the top in terms of compliance. That is part of the culture of the organization and they're asking for sort of a high level overview from the fund or advisor as to its compliance program. The SEC has been clear about what they want to see. They want to see risk identification, risk management and periodic assessment of the compliance program.

If we could turn the page (**See page 22**) these are very basic elements of a compliance program, from the point of view of someone who has been involved in compliance examinations in the past. In all of these cases, the key elements in response to these items is to be able to show documentation that shows that you've gone through the process of identifying the risks, be it through various internal reporting and risk management reporting. You must also be able to show that the systems are operating and then being able to show the periodic assessment process whereby you're responding to exceptions or problems that might occur, and tuning the systems to address those issues if they are systematic, to see if there's some pattern to them.

The next slide (**See page 23**) on SEC exams, goes through some more details on the things the SEC would be looking for. Here again, emphasizing the documentation elements of these compliance programs is key, the SEC wants to see exceptions. I am picking up on some of the remarks of some of the earlier speakers. The SEC will probably not have a positive reaction if you say you don't have anything to report. They expect that there are going to be things to look at. And they want to be able to trace the process you have in place for identification, resolution and addressing the issue if it is systematic.

Go to the next slide (**See page 24**), I think the areas of scrutiny are quite clear. I mentioned the themed aspect of this already. In this list there are a number of issues. From our perspective as a service provider, we obviously focus very closely on pricing and valuation, market timing, and transfer agency issues as well. All of these other issues come up from time to time, but the key here is to look at your business, and look at the areas you've identified as risk areas and focus on that SEC exam letter.

That letter will give you a road map to what the SEC is going to ask for. As I mentioned before, the SEC is similarly constrained on resources and doesn't have time to come up with new questions. The other thing I'll point out is that they are also asking for responses in some cases to be packaged to them in certain ways. Focus on that, in some cases they want things in sealed envelopes, directly from transfer agents. That's an interesting way to ask for examination responses. That's the end of my remarks for today.

**NH:** Thanks Greg. Let's go to Michael Leary now.

**Michael Leary:** Good morning. If we could move to Polling question #4. What methodology do you feel that your firm will rely on the most for testing the effectiveness of controls at your service provider? Due diligence visits and/or self testing of service providers' controls, sub-certifications, reliance on SAS 70 reports, or other?

Surprisingly, due diligence visits comes in at #1 at 57%, sub-certification 14% and then other 28%. I had personally thought that reliance on SAS 70 reports would be the highest one out there. So interesting responses.

Turn to the next slide, **(See page 27)** we'll get into a little more detail. From the initial publication of rule 38a-1 there's been a lot of discussion surrounding the use of third party reports. Much of the debate surrounding these reports originated from the SEC statement in the rule that CCOs could rely on service provider controls based on a SAS 70 like report.

Obviously a very general statement by the SEC, and they did not really give us too much guidance. So let's talk a little bit about that. Some background surrounding the SAS 70 reports. Typically there are two types. There's the Type I report that reports controls placed in operation. And this is a more of a point in time type of test versus a Type II report, which tests the operating effectiveness in addition to controls placed in operations over a period of time.

For example, JPMorgan's reports are all Type II reports, or Transfer Agency, Fund Accounting and Custody. These types of reports usually give greater assurance that the controls are operating effectively. So the issue in front of us is, can SAS 70 reports be utilized for reliance on the 38a-1?

Here are a couple of arguments against. SAS70 reports typically support financial reporting audit functions on the financial statements. In addition they are originally designed to be utilized as an auditor to auditor communication. Now supporting its use is the recent development surrounding Sarbanes Oxley. Typically Treasurers and CFOs over the past couple of years have been utilizing this report to gain reliance that the financial reporting process is working correctly. Obviously these people are not auditors.

In addition, the AICPA has created an expert panel that is working on its use. From what I've heard, the public accounting firms appear to be somewhat split over the solution. In addition, delays from this panel have occurred. I originally heard from some of the panel participants that they would have a format out in December. Obviously it's March now, and now I've heard a new deadline around April. So although we have had delays, it appears that once the format is agreed upon, the expert committee will be able to implement fairly quickly under generally excepted auditing standards.

So what are the alternatives out there? Turn to the next slide **(See page 28)**. The first is a modified SAS 70 report for CCO representations. There are a number of gaps in the typical SAS 70 report for example, many functions of the 40 Act, and IRS compliance are not tested under a normal fund accounting SAS 70 report. Now last week, I talked to an auditor from the AICPA expert panel at the ICI Accounting and Treasurers Committee and surprisingly enough, he had mentioned that they are still looking very seriously at the SAS 70 type of report in their discussions. Some alternatives to the SAS 70 report are, putting an AT report or Attestation Report on with the SAS 70 report, which gives a written assertion. In addition, there is an agreed upon procedure report that can also be utilized. An agreed upon procedure report is basically what it sounds like. Some of the issues with both of these reports is that they are restricted in their use. You really can't send it out to the general public and they are really not audits, so the opinion associated with them is much less in scope.

On the next page (**See page 29**), let's switch gears a little bit and discuss what JPMorgan is doing surrounding the role. As probably everyone knows, we've created a Compliance Solutions Product. We initially created a Steering Committee and a Task Force of employees from all functions that in turn, created a matrix mapping of Federal securities law, and eventually created policies and procedures summaries for use by our client CCOs and their Board of Directors.

Next page (**See page 30**). A little about history on this, the Steering Committee and the Task Force were formed in first quarter of 2004, and we broke the project into two phases. Phase one was documentation phase, phase two had the analysis of how to test effectiveness surrounding the controls.

Next slide (**See page 31**), during our phase two approach, we took the Federal Securities Law matrix and mapped it to identified controls both internally and externally. Some of those controls were key risk reporting quality assurance testing, management reporting, and also our SAS 70. We're in the process of risk rating these controls which I think is a very important part of any compliance program, since you really need to make sure a risk based approach is addressed. And the SEC has said this many times. Then based upon the coverage, we've selected certain controls to be tested and we are in the process of an RFP with various security firms to contract to do the testing. Due to the waiting results from the AICPA expert panel the format of the report is still somewhat open.

The next slide talks a little about our core services (**See page 32**), we offer representation letters, periodic control updates, policy and procedure updates which we plan to put on our Website, which Neil is going to get into in a couple of minutes in a little more detail. And also we've appointed a central point of contact which is me.

And finally, on our last slide (**See page 33**) a couple of products that we are offering. Compliance Testing Services, is through our compliance system Trac, this can also be utilized in our third party module so you do not have to do Fund Accounting at JPMorgan. Plexus is our best execution software, and i-Vault for the CCO storage needs in an online environment.

The final slide (**See page 34**) that's me, please feel free to contact me, I look very much forward to talking to you. Talking about our program and what JPMorgan can accomplish for you. I've attached my telephone number and email address below. I look forward to speaking to you.

So I'll hand it back to Neil for the remaining part of the presentation.

**NH:** Ok, thanks Michael. Are there any questions?

**Question for Sheenagh:** In terms of the investor sentiment in Europe relative to the regulation are you seeing any improvement in terms of the retail or institutional investor on the investment marketplace given these regulations?

**SGH:** Not necessarily with regard to the regulations. But there is some very interesting analysis around 2004 and what is happening in Europe. Because strangely enough with one of the worst years on record for the European mutual fund industry, certainly in Germany, probably the worst year in 13 years, and terrible in Italy, and that's against the backdrop of up-ticks in equity markets, and therefore even though one expects a bit of a lag, it certainly runs counter to the trend.

What's interesting is when you drill down, you find that the cross-border players have actually been very successful in Europe, where the domestic players have not. It's almost like a mirror image. For example, domestic groups in Europe, their equity mutual fund sales in 2004 were down 32%, where cross border groups were up 43%. So there's something strange happening here. I don't think it has anything to do with regulation per se. I think what's happened is, European investors are getting wise and getting more sophisticated. Open architecture is beginning to take hold. Where open architecture takes hold and people are looking at relative performance, total expense ratios and all of those good things, the cross border players are benefiting, and I think that's fascinating.

I think what we do need though is a more efficient mutual fund market. We have a hugely inefficient mutual fund market comparatively speaking in Europe. We have something like 28 or 29,000 mutual funds, and we've got under 4 trillion euro of assets, compared with the U.S. which has 8,300 mutual funds and over 8 trillion in U.S. assets. We've got an absence of economies of scale in Europe, we've got higher total expense ratios. What we need to see from the regulators is action to remove regulatory barriers to more cross border activity, to enable for example, cross border mergers with fund groups so we can actually start to achieve some of the economies of scale that investors need. There is a very interesting dynamic in Europe right now and cross border players are winning.

**NH:** In the interest of time, I am going to wrap up, hopefully you can see the Internet address there [Thought.magazine@jpmorgan.com](mailto:Thought.magazine@jpmorgan.com) if you have any follow up questions regarding anything you've heard today or anything else on the topic, please drop us a line, we'll get back to you as soon as we can.

Secondly just to mention one or two other things we're working on. We are putting together a new Compliance Solutions Page on our Investor Services Website [www.jpmorgan.com/investorservices](http://www.jpmorgan.com/investorservices) to enable you to link into other products and services that will help you in fulfilling compliance needs. We're also working on a client only Extranet site that will house the SAS 70 report, it will give black-lined summary documents, access to breach register custody products etc., so that will be another useful tool. More details to follow.

So I'd like to thank you on behalf of my colleagues for participating today. Hopefully you have found this as valuable as we have. Thank you very much.

1. The National Investment Company Service Association (NICSA) is a not-for-profit trade association providing leadership and innovation in educational programming and information exchange within the operations sector of the worldwide investment industry. NICSA membership totals more than 400 companies operating in major financial centers in the United States, Europe and Asia. The membership represents all segments of the mutual fund industry including mutual fund complexes, investment management companies, custodian banks, transfer agents and independent providers of specialized products and services.
2. John Langton is Chief Executive of International Securities Market Association (ISMA)
3. Martin Wolf is associate editor and chief economics commentator at the Financial Times
4. Gene Gohlke, Associate Director, Office of Compliance Inspections & Examinations SEC Inspections Office  
Note: Polls are not scientific. 36 people participated in the Webinar and may or may not have answered one or more polling questions. The Webinar was held on March 8, 2005.